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SUBJECT: PAKISTAN'S WHEAT SHORTAGE AND FOOD INFLATION ADD TO
RAMADAN WORRIES

11. SUMMARY: During this year's holy month of Ramadan, the average Pakistani is more concerned about finding a bag of flour than who will win the upcoming elections. A combination of overly optimistic production estimates, increased domestic consumption, a temporary lifting of the export ban, and rising food inflation have produced a demand for wheat imports despite 2006 carryover wheat stocks of over four million tons.

12. Over the first week of Ramadan, wheat flour was selling at nearly twice pre-Ramadan levels - if bags of flour could be found at all. Accusations of hoarding abound. The price of all food items has risen 40 percent since the start of the holy days. The GOP's announcement on September 15 that they will allow the import of one million tons of wheat somewhat calmed the markets as overall price inflation has begun to ease. In addition to the desire for food prices to return to normal, Pakistanis have two questions. Where is the wheat and will hoarders be punished for their actions? END SUMMARY.

INFLATED CROP ESTIMATE STARTED THE TROUBLE

13. The GOP continues to maintain its estimate of a 2007 bumper wheat crop of 23.5 million tons, despite average yearly production of about 21.5 million tons. Analysts questioned the official estimate throughout the growing season since the wheat planted area increased by only one percent over the previous crop year, while the official estimate reflected an incredible 10 percent rise in production. Growing conditions were indeed favorable, but most believe the crop is at least one million tons lower than the GOP estimate. (Comment: FAS Islamabad's unofficial forecast of the crop in March 2007 was 21.8 million tons. End Comment.)

14. In April 2007, the GOP lifted the ban on wheat exports that was imposed in 2003. Traders quickly took advantage of the wide price spread between Pakistani wheat and the international grain market. Exporters shipped out 500,000 tons of wheat before the GOP reinstated the export ban on wheat by land and sea on May 25, 2007. Despite the small window of opportunity, exports had the desired effect of raising farm prices. However, wheat exports also had the negative effect of starting the spiral of food inflation which would slowly simmer in early summer to ignite during Ramadan.

FOOD INFLATION MAJOR CONCERN

¶5. The GOP's inflation target for both FY 2007 and FY 2008 (July-June) was established at 6.5 percent. In FY 2007, the CPI actually rose 7.8 percent. It is estimated that the FY 2008 CPI will increase by 7.5 percent, mainly reflecting higher food prices. Food inflation this August alone reached 8.6 percent as prices for rice, beans, peas, lentils, vegetables, fruit and other food commodities rose steeply.

¶6. Wheat and flour prices began rising in May, following the brief opening of the wheat export window. By August, accusations of speculative hoarding by major traders and businessmen in Punjab and Sindh Provinces were rampant. In May, a kilo of wheat flour cost 12-14 rupees (\$0.20-0.23). By the first week of Ramadan, the cost of flour had risen 80 to 85 percent to 22 rupees (\$0.37), with widespread concern that prices would soon rise 100% to 25 rupees (\$0.42).

¶7. While wheat and flour prices initiated the inflation spiral, the cost of all food items rose 40 percent during the first week of Ramadan, due in part to the paradoxical increased demand for food during the month-long daylight fast. Families normally hold large "iftari" evening meals to break the Ramadan fast, inviting family and friends. This feasting/fasting cycle causes not only digestive complaints and weight gain, but contributes to food inflation as families prepare larger and more elaborate than normal meals.

¶8. In response to supply problems and inflationary pressure, the GOP began releasing wheat stocks to flour mills on September 7. On September 15, the GOP announced its intention to import 1 million tons of wheat. These combined actions caused a lagged reaction the following week as flour prices in the major cities are now floating around 16-18 rupees (\$0.27-0.30) per kilo, approaching the GOP's original target price of 14.25 rupees (\$0.24) per kilo. Prices in the NWFP and Balochistan are generally slightly higher due to

transportation costs -- reportedly around 20 rupees (\$0.33) per kilo.

WHERE'S THE WHEAT?

¶9. Despite the government's inflated crop estimate, there should have been plenty of wheat flour available in Pakistan at this time of year. However, a series of events caused a chain reaction resulting in empty shelves of wheat flour at retail outlets.

¶10. While destinations and volumes of exports during the April-May period are not yet officially released, likely buyers of the 500,000 tons include countries in the Middle East and South Asia, as well as India. In addition, at least one million tons of wheat and wheat flour was smuggled into India and Iran due to the favorable price differentials. While a Pakistani living in a border town can earn about one third more than his daily wage as a laborer by smuggling a single 20 kilo bag of flour into India, most smuggling is organized and carried out by influential groups.

¶11. Due to a lack of operating flour mills, wheat is not normally exported to Afghanistan. Consequently, flour is legally exported to Afghanistan with a 15 percent export tax. In addition, illegal smuggling into Afghanistan and onwards to the Central Asian Republics has siphoned flour out of Pakistan.

¶12. Speculative hoarders, mainly big commodity traders and others with sufficient influence and warehouse capacity, could be sitting on as much as 2 million tons of wheat. It is assumed that the GOP knows where much of this wheat is located but the public and press are doubtful that any of the hoarders will be held responsible for their actions.

¶13. A final factor is domestic consumption which has increased this year as well. Most of the domestic wheat utilization of 22 million tons is for human consumption; however, the high price of corn and broken rice relative to wheat has resulted in farmers increasing their utilization of wheat in poultry and livestock feed. Also, the high price of rice has contributed to increased human consumption of wheat. This has likely pushed domestic wheat demand above 23 million tons.

¶14. Taking all of the above into consideration, and assuming the GOP maintains its 4 million ton wheat reserve, analysts calculate the shortfall in wheat anywhere between 1.5 and 2.5 million tons.

IMPORTS NEEDED DURING A PERIOD OF WORLDWIDE SHORTAGE

¶15. On September 15, 2007, Prime Minister Shaukat Aziz announced that the GOP would import one million tons of wheat, stating that this action was necessary to "maintain a reasonable buffer stock for the future." The export price for Pakistani wheat during the April-May export window was approximately \$225-232 per ton. For December 2007 delivery, Pakistan is now looking at an import price of \$380-400 per ton. The timing couldn't be worse. World wheat stocks are at a 26-year low, mainly due to severe weather conditions in the major production areas of Canada, Australia, the EU and Ukraine. Consequently, wheat prices have hit all-time record highs.

¶16. The GOP subsequently decided to make smaller wheat purchases, rather than a single 1 million ton purchase. It announced a tender for 100,000 tons of wheat for December delivery with additional tenders expected monthly. GOP officials cited overbooking at the Port of Karachi and the problems berthing larger vessels as well as the need for a monthly review of the wheat situation as reasons for moving away from a single tender. They have also hinted that they may lift the ban on private imports. We expect that Pakistan will provide a subsidy for the imported wheat to cover the differential between the government issue price and the import price.

COMMENT

¶17. (SBU) The GOP unwittingly walked into a perfect storm scenario on wheat during the election season. Not only were its initial estimates of this year's wheat harvest overly optimistic, but its well-intentioned decision to lift the four-year wheat export ban further contributed to shortages and price increases. Increased

Ramadan demand further contributed to price increases and supply shortages. Inflation, particularly food inflation, is frequently cited in polls here as a primary concern of the Pakistani public. It is surprising that the Pakistanis have borne this inconvenience stoically, with no demonstrations or violence that might have occurred elsewhere.

¶18. (SBU) The food "crisis" scenario which played out this summer points to the fact that the Ministry of Food, Agriculture and Livestock does not have a coordinated long-term commodity policy. There are no staff economists or commodity experts advising policymakers on critical issues affecting the wider economy. Consequently, the GOP did not have the foresight to see the implications of maintaining an artificially high crop estimate or allowing wheat exports. Lowering the official crop estimate would have had the same effect on farm prices as exports, while keeping more wheat within Pakistan.

PATTERSON